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New Zealand

Dairy and Products

Annual Dairy Industry Report

2008

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Report Highlights:
Milk production fell 3% in MY 2008 due to a drought that engulfed most of New Zealand during the summer months. Production is forecast to rebound by 8% in MY 2009, due largely to an increase of approximately 200,000 cows over the past two years. The drought and resulting downturn in production led to a 13% drop in dairy product exports in MY 2008. However, exports are forecast to rebound in MY 2009 with cheese and nonfat dry milk expanding by 15% and whole milk powder by 13%.

Includes PSD Changes: Yes
Includes Trade Matrix: No
Annual Report
Wellington [NZ1]
[NZ]

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Section I. Executive Summary

After steadily expanding at a rate of 4% per annum since 1990, milk production in New Zealand fell 3% in marketing year MY 2008 (June/May year). The decline is attributable to the drought that engulfed most of New Zealand during January to April 2008. Milk production is forecast to rebound in MY 2009 by 8% reaching a record 16.3 million tons. The upturn is primarily attributable to an estimated increase of 200,000 cows over the past two years. While there is potential for the continued expansion of milk production in New Zealand, there are also a number of factors tempering future production increases including the high price of land, environmental constraints, and increasing on-farm costs.

The drought and resulting downturn in production led to a 13% drop in dairy product exports (excluding liquid milk exports which actually increased by 21%). Whole milk powder exports were off 7.3% while cheese, butter and nonfat dry milk were down 8.4%, 16.5% and 23%, respectively. Dairy exports are forecast to rebound in MY 2009, with cheese and whole milk powder exports expanding by an estimated 15% and whole milk powder 13%.

Soaring food prices made front page news in New Zealand earlier this year and there is growing concern regarding the affordability of food. Food prices, which rose 8.2% in the year to June, joined forces with soaring oil prices to push inflation up to 5%. However, according to Statistics New Zealand, dairy product prices were up even more. Milk was up 22%, cheddar cheese 62%, and butter 87%.

In August 2008, New Zealand's Trade Minister Phil Goff announced that a "substantive conclusion" was reached at the negotiations between ASEAN, New Zealand and Australia for a Free Trade Agreement (AANZFTA). The accord is expected to be signed at the ASEAN leaders' summit in Bangkok in December 2008 and is expected to be "comprehensive" (i.e., dealing with all market sectors including dairy).

Section II. PSD Tables

Dairy, Milk, Fluid New Zealand	2007			2008			2009		
	Market Year Begin: Jun 2006			Market Year Begin: Jun 2007			Market Year Begin: Jun 2008		
(1000 Hd, 1000MT)	Official Data	Post Estimate	New Post Data	Official Data	Post Estimate	New Post Data	Official Data	Post Estimate	New Post Data
Cows In Milk	4163	4140	4163	4200	4200	4200			4365
Cows Milk Production	15595	15600	15640	14876	15096	15141			16350
Other Milk Production	0	0		0	0	0			0
Total Production	15595	15600	15640	14876	15096	15141			16350
Other Imports	0	0		0	0	0			0
Total Imports	0	0		0	0	0			0
Total Supply	15595	15600	15640	14876	15096	15141			16350
Other Exports	61	50	76	61	92	92			110
Total Exports	61	50	76	61	92	92			110
Fluid Use Dom. Consum.	360	360	360	360	360	345			330
Factory Use Consum.	15129	15145	15159	14410	14599	14659			15865
Feed Use Dom. Consum.	45	45	45	45	45	45			45
Total Dom. Consumption	15534	15550	15564	14815	15004	15049			16240
Total Distribution	15595	15600	15640	14876	15096	15141			16350
CY Imp. from U.S.	0	0	0	0	0	0			0
CY. Exp. to U.S.	0	0	0	0	0	0			0
TS=TD			0			0			0

Dairy, Cheese New Zealand (1000 MT)	2007			2008			2009		
	Market Year Begin: Jun 2006			Market Year Begin: Jun 2007			Market Year Begin: Jun 2008		
	Official Data	Post Estimate	New Post Data	Official Data	Post Estimate	New Post Data	Official Data	Post Estimate	New Post Data
Beginning Stocks	32	46	46	6	20	20			33
Production	308	319	308	321	321	314			345
Other Imports	3	3	3	3	3	6			6
Total Imports	3	3	3	3	3	6			6
Total Supply	343	368	357	330	344	340			384
Other Exports	309	300	309	299	299	283			325
Total Exports	309	300	309	299	299	283			325
Human Dom. Consumption	28	28	28	26	26	24			24
Other Use, Losses	0	0	0	0	0	0			0
Total Dom. Consumption	28	28	28	26	26	24			24
Total Use	337	328	337	325	325	307			349
Ending Stocks	6	40	20	5	19	33			35
Total Distribution	343	368	357	330	344	340			384
CY Imp. from U.S.	0	0		0		0			0
CY. Exp. to U.S.	30	30	30	30		19			23
TS=TD			0			0			0

Dairy, Butter New Zealand (1000 MT)	2007			2008			2009		
	Market Year Begin: Jun 2006			Market Year Begin: Jun 2007			Market Year Begin: Jun 2008		
	Official Data	Post Estimate	New Post Data	Official Data	Post Estimate	New Post Data	Official Data	Post Estimate	New Post Data
Beginning Stocks	21	46	85	15	40	40			43
Production	458	419	419	385	379	391			405
Other Imports	1	1	1	0	0	2			2
Total Imports	1	1	1	0	0	2			2
Total Supply	480	466	505	400	419	433			450
Other Exports	439	400	439	360	353	367			382
Total Exports	439	400	439	360	353	367			382
Domestic Consumption	26	26	26	25	26	23			23
Total Use	465	426	465	385	379	390			405
Ending Stocks	15	40	40	15	40	43			45
Total Distribution	480	466	505	400	419	433			450
CY Imp. from U.S.	0	0	2	0	0	1			1
CY. Exp. to U.S.	30	30	34	30	30	22			25
TS=TD			0			0			0

Dairy, Milk, Nonfat Dry New Zealan (1000 MT)	2007			2008			2009		
	Market Year Begin: Jun 2006			Market Year Begin: Jun 2007			Market Year Begin: Jun 2008		
	Official Data	Post Estimate	New Post Data	Official Data	Post Estimate	New Post Data	Official Data	Post Estimate	New Post Data
Beginning Stocks	35	35	47	8	25	20			34
Production	304	304	304	262	262	265			290
Other Imports	1	1	1	0	0	1			1
Total Imports	1	1	1	0	0	1			1
Total Supply	340	340	352	270	287	286			325
Other Exports	327	310	327	257	257	251			288
Total Exports	327	310	327	257	257	251			288
Human Dom. Consumption	5	5	5	5	5	1			1
Other Use, Losses	0	0	0	0	0	0			1
Total Dom. Consumption	5	5	5	5	5	1			2
Total Use	332	315	332	262	262	252			290
Ending Stocks	8	25	20	8	20	34			35
Total Distribution	340	340	352	270	282	286			325
CY Imp. from U.S.	0	0	0	0	0	0			0
CY. Exp. to U.S.	1	1	0	0	1	0			0
TS=TD			0			0			0

Dairy, Dry Whole Milk Powder New Zealand (1000 MT)	2007			2008			2009		
	Market Year Begin: Jun 2006			Market Year Begin: Jun 2007			Market Year Begin: Jun 2008		
	Official Data	Post Estimate	New Post Data	Official Data	Post Estimate	New Post Data	Official Data	Post Estimate	New Post Data
Beginning Stocks	39	70	57	22	40	40			70
Production	653	655	653	670	670	651			710
Other Imports	1	1	1	1	1	1			1
Total Imports	1	1	1	1	1	1			1
Total Supply	693	726	711	693	711	692			781
Other Exports	670	660	670	670	670	621			700
Total Exports	670	660	670	670	670	621			700
Human Dom. Consumption	1	1	1	1	1	1			1
Other Use, Losses	0	0		0	0	0			0
Total Dom. Consumption	1	1	1	1	1	1			1
Total Use	671	661	671	671	671	622			701
Ending Stocks	22	65	40	22	40	70			80
Total Distribution	693	726	711	693	711	692			781
CY Imp. from U.S.	0	0	0	0		0			0
CY. Exp. to U.S.	4	4	4	4	4	1			1
TS=TD			0			0			0

Section III. Narration

Production

Summary
After expanding at a rate of 4% per year since 1990, milk production in New Zealand fell 3% in marketing year MY 2008 (June/May year). The decline is attributable to the drought that engulfed most of New Zealand during January to April 2008. However, milk production is expected to rebound in MY 2009 by a forecast 8%. The upturn is attributable to an increase in cow numbers and an additional 330 new dairy farms coming on stream. While there is still room for expansion of milk production in New Zealand, there are also a number of factors tempering future production increases including the high price of land, environmental constraints, and increasing on-farm costs.

Drought Conditions Result in Lower Production in MY 2008
Drought conditions covered most of the North Island and parts of the South Island from January through April of 2008, including the Waikato region, which is the main dairy producing region accounting for approximately 40% of total production.

Two regions - the west coast of the South Island and the dairy areas north of Auckland on the North Island - were largely spared from the drought. In fact, Westland Cooperative, which is located on the west coast of the South Island, reported increased milk production over last year.

Dairy Payouts Reach Record Levels in MY 2008
Fonterra, the largest milk cooperative in New Zealand with a 94% share of domestic milk production, recently finalized the MY 2007/08 season payout confirming shareholder suppliers would be paid NZ$ 7.90/kg (US $5.37) of milk solids (MS). This is the highest price ever paid out to Fonterra shareholders and is a direct result of the run up in world dairy prices. Fonterra's payout to farmer shareholders includes NZ$ 0.31/kg MS (USD 0.21) for the value-added component of the business and NZ$ 7.59/kg MS (USD 5.16) for raw milk. The Fonterra Board retained NZ$ 0.24/kg MS (USD 0.16), which means suppliers received a net of NZ$ 7.66/kg MS (USD 5.21). The Board cited the need to strengthen its balance sheet in the face of the global credit squeeze as a main reason for the retention. By way of comparison, Westland announced a payout of NZ$ 8.22/kg MS and Tatua NZ$ 8.00/kg MS. These cooperatives also announced retentions from their respective payouts.

In September 2008, Fonterra announced that its MY 2008/09 forecast payout would be $6.60/kg milk solids (US$ 4.49). Some industry sources predict that the actual payout will be on the order of NZ $6-6.50/kg MS over the next two years. While the declining NZ dollar will help insulate producers from the downturn in world dairy prices, on-farm operating costs are likely to increase by 20 to 30 cents/kg MS.

Production Forecast to Rebound in MY 2009
Milk production is forecast to increase 8% in MY 2009, due largely to the 5% increase in cow numbers over the last two years. This increase includes an additional 165,000 head on 330 new dairy farms coming on stream in late 2008.

This forecast also takes into consideration ongoing productivity gains from better feeding, improved genetics, larger economies of scale and other factors. Productivity has been increasing at an average annual rate of 8.3 kg of MS, or 2.4%, according to the Livestock Improvement Corporation. While these gains were masked last year because of the drought and lack of feed, post anticipates that they will be above average in MY 2009.

The National Institute for Water and Atmospheric Research (NIWA) is predicting average rainfall and average to slightly above average temperatures throughout New Zealand with only the far north of the North Island and perhaps the southern end of the South Island receiving less rainfall or having slightly lower soil moisture levels. Because the rainfall over the winter in most areas has been average or above average, aquifers and water tables are relatively high, especially in Canterbury.

Increased Production Capacity and Foreign Investment

There is a fairly significant increase in production capacity of milk powder coming on stream in New Zealand. As can be seen from the chart below, much of the new production capacity is owned by newcomers, some of which is funded by offshore investment. According to industry sources, once all of this new capacity is up and running, Fonterra's share of milk production will drop from 94% to approximately 90%.

Milk Processing Capacity by New Entrants in New Zealand

Processor Name	Approx Processing Capacity	Year Coming on Stream	Main Type of Production
Synlait	400	2008	WMP
NZ Dairies	200	2008	WMP
Dairy Trust (Southland)	200	2008	WMP
Mataura Milk	200	2010	WMP
OCC/Dairy Trust (OCC site)	200	2008	WMP
Dairy Trust (North Island)	200	2009	WMP

Source: Ministry of Agriculture and Forestry; miscellaneous newspaper reports

Conversions to Dairying Continue but Support Services are Stretched Thin

According to industry contacts, approximately 330 farms will be converted to dairy production in MY 2009. Most of the farms are on the South Island, particularly Southland, which is the southernmost province. There have been reports that, because contractors are stretched so thin, some of the conversions didn't have their milking sheds finished before calving season started. An additional 200 farms are expected to be converted in MY 2010.

In the future, the recent improvement in lamb prices might temper the rate of conversions from sheep and beef farms to dairy production. Additional factors that will potentially temper conversions include the cost of credit, increases in on-farm operating costs, and the falling payout price, which will likely squeeze profitability.

On-Farm Operating Cost Continue to Increase

As can be seen from the charts below, on-farm operating costs jumped 0.67 cents/kg MS in MY 2008, which is a 25% jump from the previous year. While part of this increase was due to the drought, this level of increase year-on-year is not sustainable over time, especially when the forecast payout is trending downward.

New Zealand Dairy Farming Revenue & Expenditure Estimates in NZD per kg Milk Solids(MS)			
Geographic area	**NZ Wide**	**NZ Wide**	**Waikato**
Marketing Year	**2006/07**	**2007/08**	**2007/08**
Unit of Measure	**$ /kg MS**	**$ /kg MS**	**$ /kg MS**
CASH INCOME:			
Milk Sales (net of dairy levies)	**4.50**	**7.63**	**7.63**
Net Livestock Revenue	**0.20**	**0.16**	**0.16**
Other Dairy Cash Income	**0.03**	**0.03**	**0.03**
TOTAL CASH INCOME	**4.73**	**7.82**	**7.82**
CASH FARM OPERATING EXPENSES:			
On-Farm Operating Expenses	**2.73**	**3.40**	**3.85**
CASH OPERATING SURPLUS	**2.00**	**4.42**	**3.97**

Source: Dairy New Zealand, Statistics New Zealand, post estimates
Note: Figures regarding expenditure increases are based on a 300 to 350 cow herd.

Analysis of Estimated Farm Expenditure Increases in NZD per kg Milk Solids (MS)		
Geographic area	**NZ Wide**	**Waikato**
Marketing Year	**2007/08**	**2007/08**
Unit of Measure	**$ /kg MS**	**$ /kg MS**
Estimated Increase in Operating Expenses Over Previous Year	**0.67**	**1.12**
Analysis of Causes of Increase:		
On Farm Price Inflation	**0.22**	**0.22**
Drought Effects	**0.15**	**0.60**
Cost Control Slippage	**0.30**	**0.30**

Source: Dairy New Zealand, Statistics New Zealand, post estimates
Notes: 1. Figures regarding expenditure increases are based on a 300 to 350 cow herd
2. On-farm price inflation index was 8.4% compared to 3.5% for the consumer price index
3. drought effects primarily reflect the increase in the amount and price of feed fed to affected animals
4. Cost control slippage refers to the use of extra inputs without commensurate benefits.

Environmental Concerns Over Dairying Continue to Grow

One issue receiving significant attention in New Zealand is the environmental impact of dairy production. While only 7% of New Zealand's total land area is occupied by dairy farms, there is concern that the increasing intensity of dairy farming (e.g. a steady increase in the stocking rate and production per hectare) is causing a buildup of nitrates in the soil, which are leaching into the waterways and potentially harming water quality. In addition, there is

some evidence that soil quality is being adversely affected with the loss of organic matter, compaction, and loss of micro flora and fauna.

New Zealand dairy farmers must comply with environmental regulations promulgated and administered by Regional Councils under the auspices of the Resource Management Act. While Council requirements vary by region, compliance costs associated with meeting the requirements have steadily increased over the past several years. Some industry observers believe that the growing compliance costs associated with environmental regulations will potentially diminish profitability and temper how much the New Zealand dairy industry can expand in the future.

Consumption

Consumption in MY 2008 Adjusted Downward
Post adjusted the figure for MY 2008 domestic consumption of fluid milk, butter and cheese downward, due largely to significant domestic price increases for dairy products. Soaring food prices made front page news in New Zealand earlier this year and there is growing concern regarding the affordability of food. Food prices rose 8.2% in the year to June, joining forces with soaring oil prices to push inflation up to 5%. However, according to Statistics New Zealand, milk was up 22%, cheddar cheese 62%, and butter 87%. The Commerce Commission announced in May 2008 that it is making preliminary inquiries to determine whether or not to investigate the spike in domestic dairy prices.

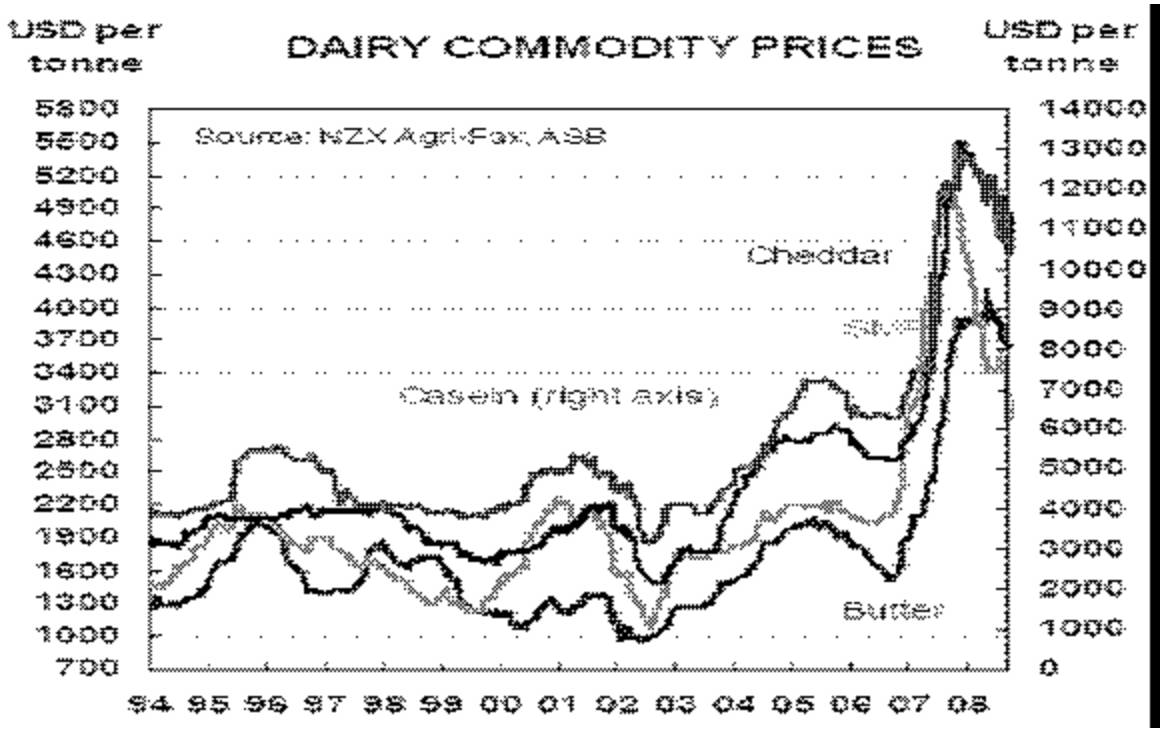
Consumption Forecast to Continue Downward Trend in MY 2009
In response to higher prices, consumers are reportedly buying fewer dairy products or smaller sizes and are looking at low priced alternatives such as milk powder. According to press reports, the demand for butter during the March 2008 quarter was down 12% from a year ago. Demand for cheese products is reportedly showing a similar trend. Post has adjusted the MY 2009 forecasts for consumption of fluid milk, butter and cheese to reflect this trend.

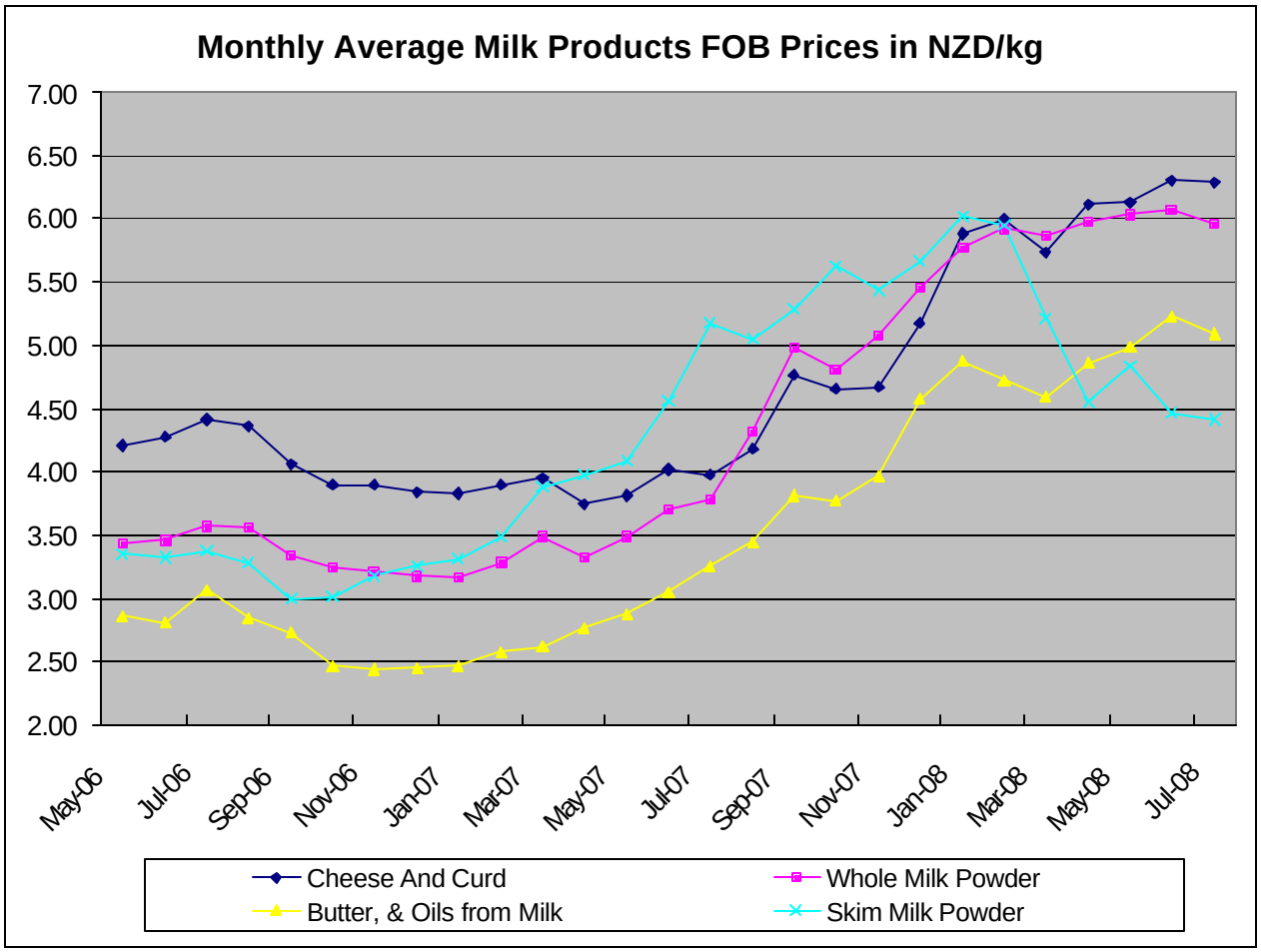
Trade

Summary
New Zealand, a major dairy exporter, accounts for a significant percentage of global trade in dairy products. Whole milk powder (WMP) is the leading dairy export accounting for just over one-third of total exports followed by butter, cheese, and non fat dry milk (NFDM). While other cooperatives do export dairy products, Fonterra, with a 94% share of domestic milk production, accounts for nearly all of New Zealand's dairy exports.

Since 2000, New Zealand's total dairy exports (other than liquid milk) have grown at a rate of 3.75%. However, the drought during the summer (January to April) of 2008 resulted in a 3% decline in milk production and a 13% drop in dairy product exports (excluding liquid milk exports which actually increased by 21%). WMP exports were off 7.3% while cheese, butter and NFDM were down 8.4%, 16.5% and 23%, respectively.

Dairy exports are forecast to rebound in MY 2009, with Cheese and Non-fat Dried Milk exports expanding by an estimated 15%, Whole Milk Powder 13%, and Butter and Anhydrous Milkfat by 4%. Since 1992, Powder and cheese exports have increased more rapidly than butter. During MY 2009, relative pricing illustrated by the charts below suggests





Source: Global Trade Atlas & World Trade Atlas

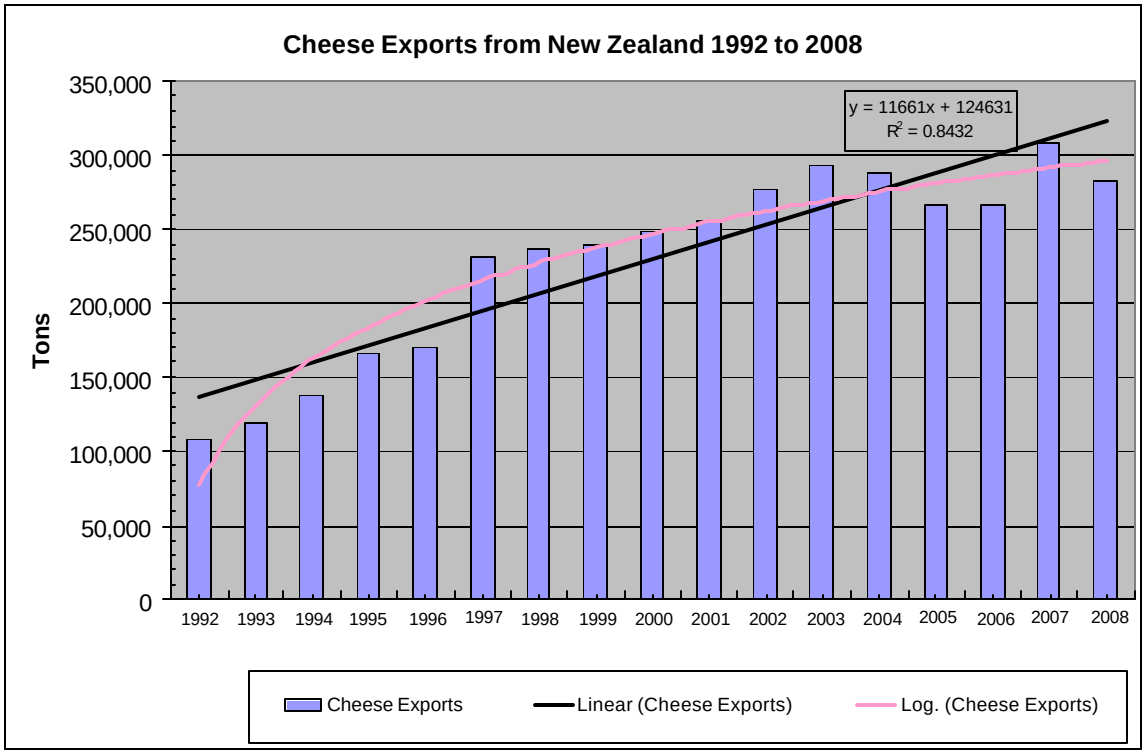
that production of WMP and cheese will increase more than that of NFDM and butter so the long term trend are likely to be reinforced with the exception of NFDM.

As dairy prices peaked at the beginning of CY 2008 it is estimated there has been some rebuilding of stocks.

Cheese Exports Fall 8.4% in MY 2008

While there has been a steady upward trend in New Zealand cheese exports over time, exports fell 26,000 tons, or 8.4%, in MY 2008, due largely to the production limitations imposed by the drought. Cheese exports are forecast to increase by 42,000 tons, or 15%, in MY 2009 reaching 325,000 tons.

In terms of cheese export destinations, the United States has fallen to fourth place in value terms behind Japan, Australia, and South Korea. As can be seen from the chart below, over the last several years, New Zealand exports to the United States have fallen steadily from 32,453 tons in MY 2005 to 18,744 tons in MY 2008.



Source: World Trade Atlas and Global Trade Atlas

New Zealand Cheese & Curd Exports (HS0406) by Destination (Tons)					
Country	**MY 2005**	**MY 2006**	**MY 2007**	**MY 2008**	**Annual Growth Rate %**
Japan	55,691	52,793	61,865	63,857	5.86%
Australia	37,207	47,265	49,754	50,399	10.10%
Korea, South	13,047	12,678	12,827	18,887	11.87%
United States	32,453	22,811	29,781	18,744	-12.89%
Saudi Arabia	9,311	12,042	11,201	12,292	7.90%
Philippines	10,878	7,539	10,412	9,916	0.45%
Belgium	12,806	13,923	21,340	8,454	-7.86%
United Kingdom	10,976	9,455	12,948	7,524	-7.86%
Egypt	5,234	7,383	13,288	7,343	17.39%
Taiwan	6,798	5,861	6,186	7,324	2.81%
China	3,592	4,172	4,366	6,972	22.57%
Mexico	11,535	13,822	12,012	6,081	-18.62%
Indonesia	3,120	2,497	3,530	5,850	25.01%
Trinidad & Tobago	4,017	5,255	4,892	5,588	9.62%
Venezuela	1,517	1,821	2,908	4,181	42.05%
Algeria	3,739	2,080	7,277	4,144	16.89%
Bahrain	790	669	799	4,014	65.79%
Malaysia	3,429	2,752	3,131	3,859	4.95%
United Arab Emirates	2,170	2,496	2,573	3,565	16.41%
Hong Kong	2,843	3,115	3,412	3,092	3.49%
Rest of the World	36,385	36,591	34,119	31,121	-5.24%
Total Exports	267,538	267,020	308,620	283,208	3.21%

Source: World Trade Atlas

Butter and Anhydrous Milk Fat Exports Fall 16.5% in MY2008

Butter and Anhydrous Milkfat (AMF) exports fell 72,000 tons, or 16.5%, in MY 2008. (Note: AMF export tonnages are multiplied by 1.22 to standardize them with butter tonnages for the PSD tables). Again, a major factor accounting for the decline is the drought induced drop in milk production. In addition, the relative pricing of butter and other commodities, as shown in the NZD FOB pricing graph above, appeared to encourage WMP and cheese production.

In MY 2009, butter and AMF exports are forecast to increase by 15,000 tons, or 4%, to 382,000 tons. In keeping with past history, the bulk of this increase will largely be AMF. While New Zealand has valuable butter quotas, over time the increase in New Zealand's butter exports has been less than 1% per annum while AMF exports have grown 9.5% annually since 1996.

New Zealand Butter Exports (HS040510) by Destination (Tons)					
Country	**MY2005**	**MY2006**	**MY2007**	**MY2008**	**Annual Growth Rate %**
Belgium	37,755	56,956	36,376	37,419	-4.64%
Denmark	30,087	33,743	22,285	32,900	-1.46%
Iran	15,765	25,108	27,704	29,055	21.32%
Russia	24,213	29,836	33,315	21,230	-2.80%
Australia	8,265	6,764	9,987	15,681	25.99%
Azerbaijan	10,747	13,684	15,414	14,408	10.50%
Egypt	11,537	15,931	23,826	12,302	6.13%
Saudi Arabia	5,442	6,544	9,189	7,832	15.39%
Taiwan	8,470	6,383	8,570	7,674	-0.01%
Morocco	4,315	8,853	8,383	7,587	17.80%
China	3,461	5,231	7,368	6,718	26.26%
Georgia	1,436	40	306	3,189	55.62%
Singapore	2,326	2,720	4,238	3,152	14.52%
Indonesia	2,427	1,836	2,444	3,151	11.29%
Hong Kong	2,802	3,445	3,963	2,960	3.10%
Malaysia	3,404	3,105	3,099	2,818	-5.53%
United Arab Emirates	2,135	2,007	1,912	2,382	2.84%
Canada	3,942	2,940	3,461	2,365	-12.81%
Fiji	1,371	1,013	1,406	1,993	15.62%
United States	4,039	3,999	6,082	1,667	-20.03%
Rest of the World	18,218	22,456	28,556	21,438	7.56%
Total Exports	202,158	252,596	257,882	237,921	5.23%

Source: World Trade Atlas

New Zealand AMF Exports (HS040590) by Destination (Tons)					
Country	**MY2005**	**MY2006**	**MY2007**	**MY2008**	**Annual Growth Rate%**
United States	24,033	22,466	22,819	16,876	-9.92%
Mexico	11,370	10,507	19,401	12,650	9.78%
Saudi Arabia	5,591	2,806	8,083	7,423	21.02%
Philippines	5,894	1,191	6,137	6,779	22.87%
Thailand	5,310	5,096	7,777	5,641	6.22%
Indonesia	2,353	3,015	3,469	5,164	28.39%
Singapore	4,403	3,757	5,548	4,726	6.21%
Egypt	3,763	3,225	6,888	4,451	13.45%
Vietnam	3,100	3,777	7,976	4,416	19.84%
Malaysia	2,288	2,179	4,025	4,070	26.38%
Rest of the World	806	302	1,470	974	23.97%
Total Exports	93,805	92,935	148,500	105,696	8.62%

Source: World Trade Atlas

Whole Milk Powder Exports Fall 7.3% in MY 2008

New Zealand's whole milk powder (WMP) exports came off their high of 670,000 tons in MY 2007 falling to 621,000 tons in MY 2008, a decrease of 7.3%. As in the case of cheese, butter and AMF, the decline is largely attributable to the drought along with some rebuilding of inventory. WMP exports are forecast to jump 13% in MY 2009 reaching a record 700,000 tons.

Venezuela has become the leading export destination by volume for WMP followed by Sri Lanka, Malaysia and Saudi Arabia. WMP exports to China have dropped off fairly significantly in the last two years.

New Zealand WMP Exports (HS040221) by Destination
(Tons)

Country	MY2005	MY2006	MY2007	MY2008	Annual. Growth Rate%
Venezuela	27,898	44,276	66,028	87,873	46.84%
Sri Lanka	45,287	47,962	53,400	52,547	5.69%
Malaysia	31,707	27,685	36,685	43,991	13.47%
Saudi Arabia	54,170	43,648	38,347	40,665	-9.42%
Algeria	24,904	37,762	32,921	38,319	12.25%
Mexico	29,342	34,491	26,292	37,067	4.39%
China	60,607	66,727	51,702	35,142	-17.22%
Philippines	31,752	25,804	30,988	31,126	1.24%
Cuba	19,913	24,025	18,872	25,135	4.68%
Indonesia	32,157	21,185	33,506	22,091	-6.46%
Thailand	20,313	18,015	25,438	21,383	5.12%
Canada	24,048	23,341	19,357	20,752	-6.10%
Vietnam	13,545	21,992	16,992	19,187	8.18%
Syria	4,515	9,273	17,822	14,969	52.94%
Nigeria	4,469	8,578	20,291	12,936	49.93%
Singapore	11,065	16,314	14,383	12,201	1.69%
Taiwan	17,072	17,715	16,370	9,855	-15.87%
United Arab Emirates	16,745	22,128	24,881	9,405	-14.90%
Oman	18,691	7,391	13,599	9,233	-13.98%
Mauritius	5,780	5,548	6,657	7,289	9.18%
United States	3,549	1,534	3,708	530	-38.26%
Rest of the World	59,184	101,712	100,582	63,886	2.21%
Total Exports	556,715	627,104	668,822	615,582	3.73%

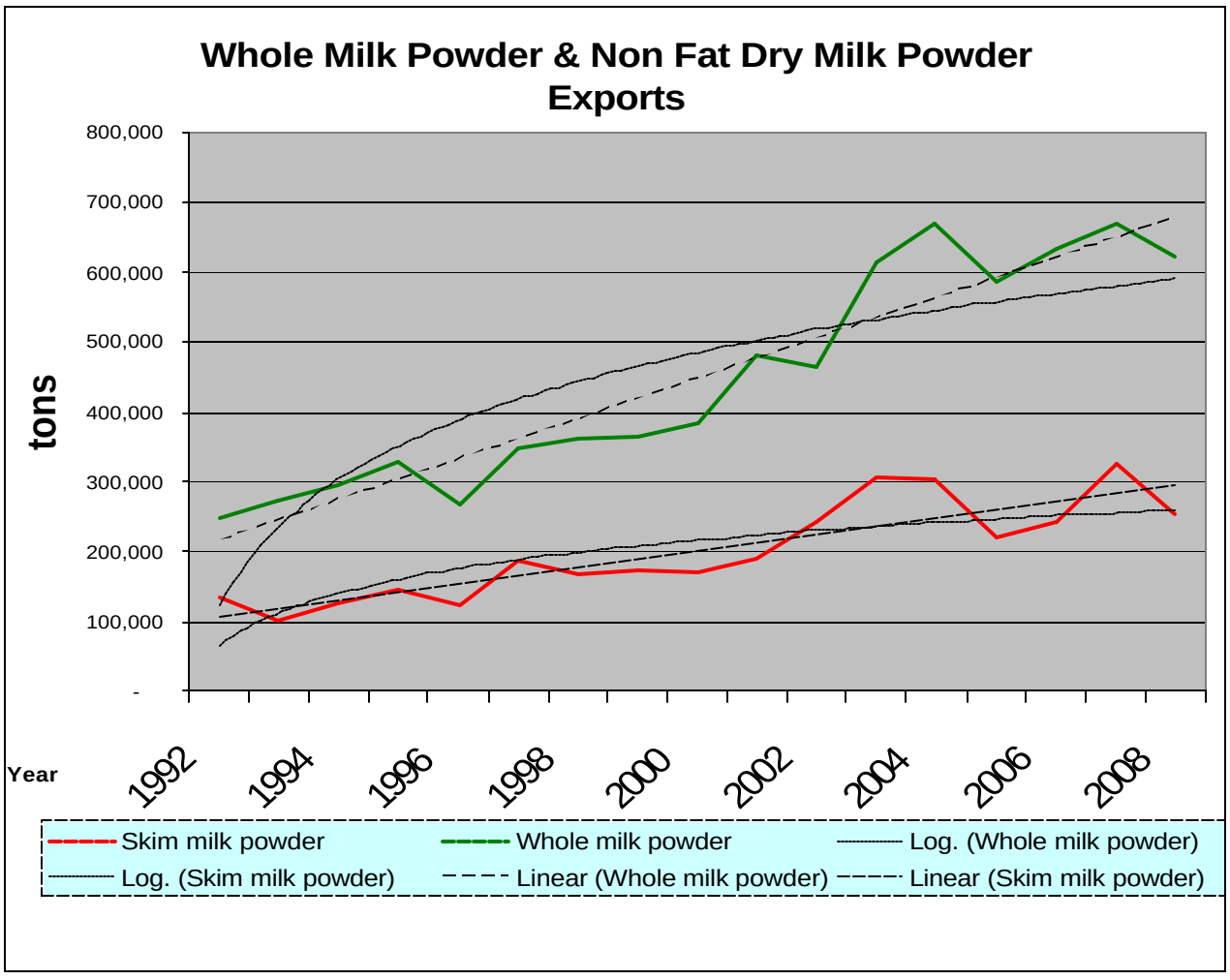
Source: World Trade Atlas

Nonfat Dry Milk Exports Fall 23% in MY 2008

Total exports of nonfat dry milk (NFDM) fell to 251,000 tons in MY 2008, a decrease of 23% compared with MY 2007. As with the other commodities, the decline is attributable to the drought that swept the country in the summer of 2008. NFDM exports are forecast to rebound in MY 2009 to 288,000 tons, a 15% increase from the previous year.

New Zealand NFDM Exports (HS040210) by Destination (Tons)					
Country	**MY2005**	**MY2006**	**MY2007**	**MY2008**	**Annual Growth Rate %**
Philippines	47,940	36,841	47,344	37,510	-4.74%
Malaysia	20,132	17,340	25,957	23,317	8.81%
Indonesia	13,447	23,224	29,873	22,919	20.34%
Saudi Arabia	15,666	17,574	22,940	21,765	13.35%
Vietnam	4,692	7,686	12,746	19,775	61.95%
Singapore	12,512	12,985	18,179	19,593	18.32%
Mexico	4,227	8,152	10,366	16,598	54.40%
Thailand	16,876	19,276	30,373	16,070	3.13%
China	22,495	29,863	25,654	12,762	-16.91%
Taiwan	8,584	10,405	11,918	8,118	-0.32%
United States	528	353	227	161	-33.00%
Rest of the World	53,991	59,220	91,641	52,705	3.71%
Total Exports	221,089	242,920	327,218	251,294	7.06%

Source: World Trade Atlas



Source: World Trade Atlas and Global Trade Atlas

Ice Cream, Whey, Casein and Other Products

All of the other product groups recorded double digit percentage decreases in export volumes in MY 2008 with the exception of liquid milk and whey products, which increased by 21% and 23% respectively. Casein products fell from 91,644 tons in MY 2007 to 78,467 tons in MY 2008, a 14% decrease. The United States is the top export destination taking 42,417 tons in MY 2008. Milk Protein Concentrate (MPC) exports fell to 78,667 tons in MY 2008, a decline of 26% from MY 2007. The United States continues to be the largest export market but New Zealand exports fell to 44,767 tons in MY 2008, down from 53,585 tons the previous year.

Policy Issues

New Zealand Government Conducts Review of DIRA

In response to longstanding concerns on the part of industry players, the New Zealand Government (NZG) announced in August 2007 that it would review the Dairy Industry Restructuring Act (DIRA), which provided for the restructuring of the New Zealand dairy industry in 2001. This legislation facilitated the merger of New Zealand's two largest dairy manufacturing companies – New Zealand Dairy Group and Kiwi Cooperative Dairies Limited – and the assets of the New Zealand Dairy Board to form Fonterra Cooperative Dairy Company Limited (Fonterra). Two companies - Tatua and Westland - opted not to join Fonterra.

Access to Dairy Quota Markets

Among other things, DIRA brought to an end the former New Zealand Dairy Board monopoly over exports of dairy products. The DIRA also provided, on a transitional basis, for the establishment of eleven regulated dairy markets and provided Fonterra with exclusive access for a fixed period of time. These fixed periods started to expire in mid-2007 and will completely expire in 2010.

These regulated markets were reviewed by the NZG in 2007 and the DIRA provisions relating to them were amended by the parliament in December 2007. Provision was made to deregulate two of the regulated markets, one in 2008 and one in 2010. For the remaining markets, the Ministry of Agriculture and Forestry (MAF) now allocates export licenses annually among eligible dairy processors on the basis of the percentage of milk solids that a processor collects directly from New Zealand dairy farmers. On the basis of a Ministerial decision, MAF issues export licenses to eligible processors for one quota year at a time and allows them to be transferred under certain conditions. From 2010, all of the remaining regulated markets will be allocated annually.

Dairy Industry Restructuring Act 2001: Schedule of Designated Markets

Market	Product	Expiration Date	New system at expiry
Dominican Republic	Milk Powder	June 30, 2007 (extended to December 31, 2007)	Allocate licenses to eligible participants
Canada	Butter	July 31, 2007 (extended to December 31, 2007)	Export restrictions no longer apply
European Communities	Butter and Cheeses	December 31, 2007 (25% of rights)	Allocate licenses to eligible participants
European Communities	Butter and Cheeses	December 31, 2008 (another 50% of rights)	Allocate licenses to eligible participants
USA	Cheddar Cheese and Low-Fat Cheese	December 31, 2008	Remove some export restrictions; and allocate some licenses to eligible participants
USA	NSPF Cheese and American-Type Cheeses	December 31, 2009	Remove some export restrictions; and allocate some licenses to eligible participants
European Communities	Butter and Cheeses	December 31, 2009, (another 75% of rights)	Licenses allocated to eligible participants
Japan	Prepared Edible Fat	March 31, 2010	Licenses allocated to eligible participants
Japan	Cheese	March 31, 2010	Export restrictions no longer apply
European Communities	Butter and Cheeses	December 31, 2010 (another 100% of rights)	Licenses allocated to eligible participants

Source: New Zealand Food Safety Authority and Ministry of Agriculture and Forestry

Dairy Industry Restructuring Act 2001: Export Licenses for Designated Markets

(Allocations in kilograms/2008 Quota Year)

Butter to the European Communities	Sub-period one (January 1 – June 30)	Sub-period two (July 1 – December 31)
Fonterra Cooperative Group Ltd	8,861,519	8,861,520
Westland Cooperative Dairy Company Ltd	300,039	300,040
Tatua Cooperative Dairy Company Ltd	89,402	89,402
Open Country Cheese Company Ltd	85,664	85,664
Total Allocated	**9,336,624**	**9,336,626**

Cheese for Processing to the European Communities	
Fonterra Cooperative Group Ltd	967,250
Westland Cooperative Dairy Company Ltd	32,750
Tatua Cooperative Dairy Company Ltd	*Nil*
Open Country Cheese Company Ltd	*Nil*
Total Allocated	**1,000,000**

Cheddar Cheese to the European Communities	
Fonterra Cooperative Group Ltd	1,692,688
Westland Cooperative Dairy Company Ltd	57,312
Tatua Cooperative Dairy Company Ltd	*Nil*
Open Country Cheese Company Ltd	*Nil*
Total Allocated	**1,750,000**

Milk Powder to the Dominican Republic	
Fonterra Cooperative Group Ltd	4,555,746
Westland Cooperative Dairy Company Ltd	154,252
Tatua Cooperative Dairy Company Ltd	45,962
Open Country Cheese Company Ltd	44,040
Total Allocated	**4,800,000**

Source: New Zealand Ministry of Agriculture and Forestry

Notes:

1. All licenses in these tables are valid from 1 January 2008 to 31 December 2008, subject to the EU requirements for limiting total butter quota volume in the first sub-period of the 2008 calendar year butter quota.
2. For the designated market for butter to the EU, no more than 50% of the total quantity for the year may be used in the first sub-period (from 1 January to 30 June). However, any quantity not used in the first sub-period may be used in the second sub-period (1 July to 31 December).
3. All quantities listed are in kilograms. Some quantities listed have been rounded to the nearest kilogram.
4. Export licenses conferred on New Zealand Dairy Board in 2001 are not included in these tables, but remain valid until the specified expiry dates set out in the Dairy Industry Restructuring Act 2001.

In spite of the DIRA amendment, Fonterra still has over a 95% share of the export quota allocation. Although Fonterra will continue to maintain a dominant share, it is likely that, in future years, the quota allocations will be spread somewhat more broadly among processors. This is largely because the initial EU allocations are progressively expiring (50% this year, 75% next year, and then 100% allocated under new system the following year) and because of an increase in the number and capacity of independent processors, including Synlait, New Zealand Dairies, and Open Country Cheese. (Note that Open Country Cheese is being taken over by Dairy Trust.) However, it is worth noting that, because of the international credit

crisis, the pace of expansion may not be as fast as otherwise thought because of the inability of some of these firms to secure financing.

Regulated Raw Milk Price

In addition to addressing access to export quota markets, DIRA also addressed domestic pricing and competition issues. Among other things, DIRA aimed to protect firms that previously purchased milk from Fonterra's predecessor cooperatives from monopoly pricing, and foster competition by providing an entry path for new processors into the market by ensuring access to fluid milk at a set price.

DIRA gave the NZG the ability to regulate up to 5% of Fonterra's milk supply. Based on the 2006/07 season, this entitled the NZG to require Fonterra to supply up to 750 million liters at a predetermined or "default" price to other independent processors. However, the NZG has never utilized the full amount. During the 2001/06 period, it required Fonterra to supply 400 million liters of raw milk per annum to other processors. This level was increased to 500 million liters in 2007/08 and further increased to 600 million liters for 2008/09, but is still below the amount permitted in the regulation.

In response to long standing concerns on the part of industry players, a key element of the 2007 DIRA review was access to regulated milk and how it is priced. Under DIRA, Fonterra is required to supply regulated milk to other processors at the "default" price. This price is currently set at NZ $7.24 per kilogram of milk solids, which is NZ 66 cents less than the price that Fonterra purchases milk from its own suppliers. Not surprisingly, the NZG review found that the formula for setting the default price results in independent processors accessing milk from Fonterra at a lower price than Fonterra pays its own suppliers. It also found that there is no mechanism in the regulations to manage excess demand for regulated milk by independent processors.

After completing the review and consulting with stakeholders, MAF recommended in August 2008 that Fonterra's farm gate price for milk become the default price for regulated milk as of June 1, 2009. MAF also recommended that the volume of regulated milk be kept at 600 million liters but that an auction system be implemented in 2010/11 to allocate regulated milk. While the details of the auction design have not been finalized, it will likely be run annually, use an online platform, and be a simple ascending auction. It will also likely be a closed auction where only registered independent processors can participate. The auction would essentially allow independent processor to bid for the right (obligation) to purchase raw milk at Fonterra's farm gate price.

MAF put forward this proposal in spite of a recommendation from the New Zealand Commerce Commission to increase the quantity of regulated milk to five percent of Fonterra's supply. The Commission also recommended a review of the sunset clauses in DIRA, which require Fonterra to supply regulated milk until a level of competitive supply is available. When the sunset "triggers" are met, which could be between 2012 and 2014, the obligation to provide regulated milk will abruptly end. (See section below explaining trigger mechanisms for the sunset clause.)

The NZG has basically signaled that it will follow MAF's recommendation and a draft bill has been drawn up. However because the New Zealand general election is to be held on November 8, 2008, the bill will not go through the Parliament this year. There is reportedly bi-partisan support for the bill and, whatever the outcome of the election, it is expected that the bill will go through parliament during the first six months of 2009.

Overview of DIRA Trigger Mechanisms

Under the current DIRA regulations, once production triggers on both the North and South Islands are met, the requirement for Fonterra to supply regulated milk will cease. The triggers, which are different for the South and North Islands, are as follows:

- South Island: independent processors collect at least 65 million kilograms of milk solids (approximately 780 million liters) in a season and one independent processor collects at least 25 million kilograms (approximately 300 million liters) of milk solids from dairy farmers outside the border of the Westland Regional Council; and
- North Island: independent processors collect 12.5% or more of milk solids from dairy farmers in a season (or conversely, Fonterra's market share falls to 87.5%).

For the South Island, both parts of the trigger are expected to be met during 2008/09. For the North Island, independent supply needs to reach approximately 1.25 billion liters for the trigger mechanism to be met, which will likely occur between 2012 and 2014.

Independent Processors (other than Fonterra) that Source Milk Directly from Farmers in New Zealand

South Island					
Processor Name	**Status**	**Approx Processing Capacity 2008/09 (mL)**	**Approx Processing Capacity 2009/10 (mL)**	**Main Type of Production**	**Comment**
Westland	Existing	550	No change	Varied	Note that Westland processed milk from Synlait and NZ Dairies suppliers in 2007/08
Synlait	New	400	No change	Whole Milk Powder (WMP)	Expected to process in excess of 25 million kgs of milk solids
NZ Dairies	New	200	No change	WMP	
Dairy Trust	New	200	No change	WMP	
Mataura Milk	New			WMP	200mL in 2010/11
Total		1,350	1,550		
North Island					
Tatua	Existing	200	200	Varied	
OCC/Dairy Trust	Existing	180	180	Cheese	
OCC/Dairy Trust	New	200	200	WMP	
Dairy Trust	New		200	WMP	Dairy Trust is planning on two or three additional sites; most likely 200 million liters each.
Total		580	780		

Source: Ministry of Agriculture and Forestry; miscellaneous newspaper reports

New Zealand and Australia Announce FTA with ASEAN Countries

In August 2008, New Zealand's Trade Minister Phil Goff announced that a "substantive conclusion" was reached at the negotiations between ASEAN, New Zealand and Australia for a Free Trade Agreement (AANZFTA). Leaders from New Zealand, the 10 ASEAN nations, and Australia initially agreed in 2004 to launch negotiations on an FTA with the first round of negotiations held in March 2005. The accord is expected to be signed at the ASEAN leaders' summit in Bangkok in December 2008 and is expected to be "comprehensive" (i.e., dealing with all market sectors including dairy). Whether a full and "comprehensive" trade agreement can be signed by year's end is not yet known but New Zealand's major trade goal continues to be securing greater market access for agricultural products in the rapidly growing ASEAN economies. The ASEAN countries account for approximately 10% of New Zealand's agricultural exports and are growing rapidly. New Zealand's agricultural exports to Indonesia, its seventh largest agricultural market, were up 37% in 2007. Agricultural exports to the Philippines, New Zealand's eight largest market, were up 39% in 2007 and agricultural exports to Malaysia, New Zealand's twelfth largest market jumped 43%. New Zealand's agricultural exports to Thailand and Vietnam increased 16% and 49%, respectively, in 2007. Dairy products, beef and sheep meat products and food preparations are the leading exports to the region.

The AANZFTA marks the latest in a series of trade agreements that are part of the New Zealand Government's strategy to expand trading networks between New Zealand and the pan-Asian economies. In April 2008, New Zealand became the first OECD country to sign an FTA with China. In May, Prime Minister Helen Clark also led a trade delegation to Japan and South Korea to begin preliminary discussions on the start of free trade talks with both countries while Trade Minister Goff announced simultaneously that progress is being made on securing a trade agreement with India.

In addition to AANZFTA and the China-NZ FTA, New Zealand has the following FTAs in force: the Closer Economic Relations Agreement with Australia (1983), an agreement with Thailand (2005) and the "P4" Agreement with Singapore, Chile and Brunei (2005). New Zealand is currently negotiating free trade agreements with Malaysia and the Gulf Cooperation Council.

Melamine in Dairy Products

Fonterra, the largest dairy cooperative in New Zealand, has a 43% holding in San Lu, the Chinese dairy company at the center of the melamine scandal. (Melamine mimics the presence of protein in milk under certain quality testing procedures. It allows companies to dilute milk with water but still obtain an increase in the measurement of protein by increasing the nitrogen levels in the milk.) Fonterra paid $153 million for its stake in San Lu in 2005. At this point, it isn't clear what the impact will be on Fonterra's balance sheet or its so-called "Behind the Borders" marketing strategy, which focuses on supplying the growing market for fluid milk in developing countries.

According to press reports, Chinese and South Korean officials have found traces of melamine in lactoferrin produced by Tatua, a New Zealand dairy cooperative. Lactoferrin is used in baby formula and nutraceutical drinks. According to press reports, the products tested in New Zealand that were positive for melamine were less than four parts per million, which is within a new food safety standards set by the New Zealand Food Safety Authority.

On September 26, 2008, the New Zealand Food Safety Authority (NZFSA) adopted a threshold of 5 parts per million (ppm) of melamine for most foods. However, for starter infant formula, this level will be set to the current level of test detection of 1 ppm.

Status of Capital Restructuring

Fonterra Co-operative Ltd began a consultation with its farmer shareholders in December 2007 on a capital restructuring plan that would have provided funding for Fonterra to expand into China, India and other growth markets. Under the preferred option put forward to shareholders, Fonterra would have transferred its assets, liabilities and operations to a separate company that would have been listed on the New Zealand stock exchange in 2010. Fifteen percent of the shares would have been provided to existing farmer shareholders and 65 percent would have been held by the cooperative. Outside investors would have been able to purchase the remaining 20 percent. However, the farmer shareholder response to the proposal was mixed. Rather than risk a no vote, Fonterra opted to indefinitely postpone the vote and continue the debate. It is unclear how the melamine tragedy in China will impact on the capital restructure debate and Fonterra's value-added business strategy in Asia.

Fonterra Auction of WMP

In July 2008, Fonterra initiated its internet-based auction system. Up to 200,000T of WMP may be sold through this channel during MY2009. The format of the auction allows Fonterra to set an opening price and buyers nominate a quantity. With each round Fonterra increases the price and buyers amend their quantities until the volume offered matches the quantity bid. An over view of the results to date are shown below.

Price History of the Fonterra WMP Auction System

Date of Auction	2-Jul-08	5-Aug-08	2-Sep-08	1-Oct-08
Shipment Months at NZ Ports	Sep-08 Oct08 - Dec08 Jan09 - Mar09	Oct-08 Nov08 - Jan09 Feb09 - Apr09	Nov-08 Dec08 - Feb09 Mar09 - May09	Dec-08 Jan09 - Mar09 Apr09 - Jun09
Offer Quantities WMP (MT)	11,000	17,500	25,000	23,000
Weighted Average Prices (USD/MT, Free Along Side Ship)	4,395	3,843	3,306	2,917
Change in Prices		-12.6%	-14.0%	-11.8%
Approximate USD to NZD exchange rate on auction date	0.76	0.70	0.67	0.61
Weighted Average Price of All Products in NZD	5783	5490	4935	4781
Change in Prices (%)		-5.1%	-10.1%	-3.1%

source data GlobalTradeDairy

NZ Government Emissions Trading Scheme Becomes Law

The new Emissions Trading Scheme which became law in September 2008 is essentially a cap and trade system with an ambitious long-term goal of reducing emissions to zero. The farming sector will be included in the scheme from 2013 with an initial free allocation equivalent to 90% of the sector's emissions in 2005. The free allocation will be reduced to zero progressively between 2018 and 2030. Approximately 48% of New Zealand's greenhouse gas emissions come from agriculture. The most significant source is methane emissions from livestock.

The potential impact of the new legislation on New Zealand agriculture is significant. According to research undertaken at Lincoln University, a 350 cow dairy farm would emit 1,632 tons CO2 equivalent per annum. At a carbon price of NZ $25.00 per ton (US $17),

this would cost the dairy farm $40,804 per year (US $27,746). This would equate to approximately 40¢ per kg of MS (US $0.27), or an increase in operating costs of 10% to 15%. However, the Act does allow for periodic reviews. If there are no practical ways for the majority of farmers to reduce or eliminate emissions and the competitiveness of the industry is threatened, then the New Zealand Government could review the timing of the removal of the free allocation units. Depending on the outcome of the New Zealand election scheduled for November 2008, the Act could be amended as well.

Appendix 1. Further Information and Links

Fonterra
http://www.fonterra.com/wps/wcm/connect/fonterracom/fonterra.com/Home/

MAF Situation and Outlook for NZ Agriculture and Forestry
http://www.maf.govt.nz/mafnet/rural-nz/statistics-and-forecasts/sonzaf/2008/index.htm

Additional Information on DIRA can be found at:
http://www.maf.govt.nz/mafnet/publications/dairy-restructuring-review/

GlobalTrade Dairy Fonterra auction site
http://www.globaldairytrade.info/DesktopDefault.aspx?tabid=417

Appendix 2. Reports Submitted by AgWellington in CY 2008

Previous GAIN Reports		
NZ8024	**Agricultural Situation Chinese Infant Formula Contamination Involves Fonterra**	**September 19, 2008**
NZ8022	**Trade Policy Incident New Zealand & Australia Sign an FTA with ASEAN countries**	**September 2, 2008**
NZ8020	**Livestock and Products Beef and Cattle Annual Report 2008**	**September 3, 2008**
NZ8009	**Dairy & Products New Zealand Semi-Annual Report**	**May 15, 2008**
NZ8007	**New Zealand Announces FTA with China**	**April 17, 2008**
NZ8003	**Impact of Drought on New Zealand Milk Production**	**March 11, 2008**